

Winspear Business Reference Room
University of Alberta
1-18 Business Building
Edmonton, Alberta T6G 2R6



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Sterne Stackhouse Inc.

our technology ensures your success

1997 ANNUAL REPORT



PRESIDENT'S REPORT



D.K. Stackhouse and H.R. Sterne

To our **Shareholders:**

Darryl and I would like to thank you for your support throughout our first year as a public company. Although the stock market's interest in "small-cap" companies has not been as strong this past year, you have stayed with us, and we believe your patience will be rewarded. Regardless of market cycles in which different sizes of companies tend to be in or out of favour, our goal is to become increasingly profitable so we can continue to enhance and expand Labrador® to prepare it for global markets.

While, without question, 1997 has been the most challenging year in our corporate history, it has also been our most rewarding. We made a fundamental commitment to you in our Prospectus to grow the company, and we have been most mindful of our responsibility to deliver.

If you turn to our financials at the end of this report, you will know that we have delivered strong financial results. However, Darryl and I believe that the way to achieve growth is through the attraction and development of quality employees. Our reasoning is simple: in the software business, good people are a critical success factor. In the past two years, we have doubled our staff. While assimilating new staff in a relatively short period of time is taxing on everyone, the transition has worked out extremely well. I have never known a group of people with such intense passion for the company and its technology.

This brings me to one of the most compelling aspects of the software business - talented, focused people can generate a great deal of sophisticated code with far reaching scope. In our view, I have just defined Labrador®.

We have proceeded with our plan to achieve growth through Labrador® by employing its generic functionality as the working proof of its usefulness in the core of the oil and gas industry. In the past year, there has also been an accelerating trend towards growth through mergers and acquisitions. In response, we are "open", but cautious. To proceed with any type of merger, we would need to ensure that the corporate cultures are compatible, and that we have the realistic potential to achieve a significant multiplier in terms of distribution.

Fortunately, we have some measure of independence because our ability to model and retrieve data from any relational database, internal or external, is already well suited for other industries. Thus, we are able to move quickly to another industry. As our profile and marketing presence are high, three opportunities have already presented themselves in recent months; and we are interested because Labrador®'s generic applicability affords the potential to create significant leverage and share value for the company. At this point, it is really a question of the proper timing and the right business arrangement.



Sterne Stackhouse Inc. Staff



In the meantime, our programmers have worked very hard to produce a battery of truly integrated products to service the petroleum sector. We took our first product, fieldLAB™, and integrated it with our petroleum software "umbrella" product, Petro-LAB™. We then expanded Petro-LAB™ to include landLAB™, pipeLAB™, resLAB™, seisLAB™, and mapLAB™, all built using our Labrador® retriever technology, and all delivered since our Prospectus. We believe that the development of the Petro-LAB™ suite of products is particularly important, not only because of its suitability for our growing list of oil and gas clients, but also because it clearly demonstrates how Labrador® can be used to service other industries. It's all about change, and how Labrador® is positioned to facilitate it.

For example, recent changes in the way business is being conducted in the oil and gas industry confirm how Labrador®'s generic retrieval capabilities can materially help an organization. An environment where, previously, departments such as exploration, land, production, and accounting worked virtually independently has been transcended by the concept of Business Units and Asset Profit Centres. Now, through Petro-LAB™, geophysicists, geologists, engineers, landmen, and financial analysts can work together, and share data together, in order to manage

specific groups of oil and gas properties more effectively. In this manner, Labrador®'s unique data retrieval and integration capabilities allow production and drilling results to be examined in the context of costs and revenues, so that management can examine the "whole picture".



Training Centre

We believe that this new paradigm for the oil and gas business is typical of businesses in general. Although the North American economy is strong, competition is fierce; and while global marketing opportunities are exciting, they also bring forth world class competitors. Just like the oil and gas business, other industries need to retrieve data selectively from many different sources, both remotely and internally, in order to make better business decisions.

As the advancements in telecommunications are now offering high-speed links which provide amazing performance, as well as ready access to global markets, Labrador® is positioned to provide substantial value to businesses in general.



D.K. Stackhouse, C.F.O.

Thus, throughout 1998, we will continue to aggressively expand Labrador® as our generic data retrieval engine. As well, we will continue to develop its companion product, Model-LAB™, which models/maps relational databases so that Labrador® can retrieve from them. We have already used Model-LAB™ to "map" a number of proprietary databases for clients, allowing them to use the same user interface regardless of where the data is sourced. This results in dramatically reduced learning curves, as the same data query "look and feel" and display capabilities are used no matter which type of data is requested.

This past year has also been a year for expanding our relationships with an increasing variety of data vendors. Clients can now use our software to remotely retrieve a myriad of data combinations required in day to day operations. Similarly, we have doubled our client base to 18 companies, with 100% renewal rates since Labrador® was first released in 1994. We are particularly proud that we have developed exceptional relationships with our clients which comprise a complete cross-section of sizes, from Juniors to Major companies. To address this growth, we have designed and built new facilities which include the Training Centre featured in this report. This room is equipped with the finest



display technology available, allowing us to triple the number of participants in each session. In general, we can now service our clients much more efficiently.

Our financial numbers illustrate our progress. We have more than tripled our revenues in 1997 over 1996, and produced pretax earnings of 3.5 cents per share in our first year as a public company. Further, we are expecting continued aggressive expansion in 1998, as we are currently marketing to an additional 50 companies. In other words, we believe we can achieve strong growth without including the possibility of revenues from either the U.S. petroleum market, or our positioning for other industries such as health care, finance, or insurance. In summary, we are "on track", and Darryl and I believe that the company's prospect for growth in the oil and gas business, as well as in other industries, has explosive potential.

Respectfully, on behalf of the Board of Directors,



H. Ronald Sterne
President & Chief Executive Officer



Labrador® billboard in downtown Calgary



AUDITORS' REPORT

To the Shareholders of
Sterne Stackhouse Inc.

We have audited the balance sheets of **Sterne Stackhouse Inc.** as at October 31, 1997 and 1996 and the statements of income (loss) and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Ernst + Young

Calgary, Canada
January 13, 1998

Chartered Accountants



Sterne Stackhouse Inc.
Incorporated under the laws of Alberta

BALANCE SHEETS

As at October 31

	1997	1996
	\$	\$
ASSETS		
Current		
Cash and short-term investments	622,168	—
Accounts receivable [notes 4 and 5]	484,697	189,204
Investment tax credits receivable	—	51,177
Prepaid expenses	18,768	—
	1,125,633	240,381
Capital assets [notes 2, 4 and 5]	154,100	95,513
Program development [note 3]	800,947	507,418
	2,080,680	843,312
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank indebtedness [note 4]	—	238,358
Accounts payable and accrued liabilities [note 10]	180,409	87,860
Current portion of long-term debt [note 5]	138,961	17,244
	319,370	343,462
Long term debt [note 5]	329,820	265,265
Deferred income taxes [note 7]	4,000	—
	653,190	608,727
Commitments [note 9]		
Shareholders' equity		
Share capital [note 6]	1,733,141	642,923
Deficit	(305,651)	(408,338)
	1,427,490	234,585
	2,080,680	843,312

See accompanying notes

On behalf of the Board:

Director

Director



Sterne Stackhouse Inc.
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STATEMENTS OF INCOME (LOSS) AND DEFICIT

Years ended October 31

	1997 \$	1996 \$
REVENUE		
Product sales	1,565,916	464,954
Consulting and support income	16,506	27,362
Other income	21,952	10,434
	1,604,374	502,750
EXPENSES		
General and administration	599,786	317,621
Sales and marketing	477,042	126,090
Computer and related costs	146,287	96,429
Amortization of program development costs	122,327	99,047
Interest — short-term	5,664	23,240
long-term	43,151	10,270
Depreciation	14,430	12,100
	1,408,687	684,797
Income (loss) before income taxes	195,687	(182,047)
Provision for deferred income taxes [note 7]	93,000	—
Net income (loss) for the year	102,687	(182,047)
Deficit, beginning of year	(408,338)	(226,291)
Deficit, end of year	(305,651)	(408,338)

Net income per common share [note 8]

See accompanying notes



Sterne Stackhouse Inc.
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STATEMENTS OF CASH FLOWS

Years ended October 31

	1997	1996
	\$	\$
OPERATING ACTIVITIES		
Net income (loss) for year	102,687	(182,047)
Items not requiring a current cash outlay		
Depreciation and amortization	136,757	111,147
Amortization of lease inducements	(5,130)	(10,262)
Deferred income taxes	93,000	—
	327,314	(81,162)
Net change in non-cash working capital	(165,405)	(60,569)
Cash used in operating activities	161,909	(141,731)
INVESTING ACTIVITIES		
Additions to program development costs	(386,077)	(357,938)
Investment tax credits applied against program development costs	—	168,734
Additions to capital assets	(102,796)	(55,630)
Cash used in investing activities	(488,873)	(244,834)
FINANCING ACTIVITIES		
Issuance of shares	1,001,218	73,930
Repayment of long-term debt	(33,728)	(22,015)
Proceeds from long-term debt	220,000	250,000
Cash provided by financing activities	1,187,490	301,915
Net increase (decrease) in cash resources	860,526	(84,650)
Bank indebtedness, beginning of year	(238,358)	(153,708)
Cash and short-term investments (bank indebtedness), end of year	622,168	(238,358)

See accompanying notes



Sterne Stackhouse Inc.

Incorporated under the laws of Alberta

NOTES TO FINANCIAL STATEMENTS

October 31, 1997 and 1996

1. SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Company have been prepared in accordance with generally accepted accounting principles. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

Revenue recognition

Substantially all of the Company's product revenue is earned from licenses to use the Company's software. Revenue from these licenses is recognized when the product is delivered and persuasive evidence of an agreement with the customer exists.

Capital assets

Capital assets are recorded at cost. Depreciation is provided at rates designed to amortize the cost of the assets over their estimated useful lives as follows:

Computer equipment	30%	—	declining balance
Leasehold improvements	20%	—	5 years straight line
Furniture and equipment	20%	—	declining balance
Computer software	50%	—	declining balance

Equipment attributable to program development activities is amortized as described under program development costs.

Program development costs

Program development costs relate to the development of oil and gas computer software which, in management's opinion, has a clearly defined future market. These costs are deferred and amortized on a 20% declining balance basis. The Company reviews the useful life of its software annually and, if required, adjusts amortization accordingly.

Direct costs and overhead costs directly attributable to development activities are included in program development costs.

Research costs are expensed as incurred.



Sterne Stackhouse Inc.
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NOTES TO FINANCIAL STATEMENTS

October 31, 1997 and 1996

Financial instruments

Financial instruments include accounts receivable, accounts payable and accrued liabilities and long-term debt. The fair values of these instruments approximate their book values.

Investment tax credits

Investment tax credits are accounted for using the cost reduction method, under which investment tax credits claimed are deducted from the cost of the related assets or expense with depreciation and amortization being calculated on the net amount.

Income taxes

The Company follows the tax allocation method of recording income taxes. Under this method, full provision is made for deferred income taxes which arise as a result of claiming deductions permitted by income tax legislation that are different from those provided in the accounts.

2. CAPITAL ASSETS

1997			
	Cost	Accumulated Depreciation	Net Book Value
	\$	\$	\$
Computer equipment	532,693	454,799	77,894
Leasehold improvements	25,573	20,118	5,455
Furniture and equipment	111,859	70,088	41,771
Computer software	73,426	44,446	28,980
	743,551	589,451	154,100
1996			
	Cost	Accumulated Depreciation	Net Book Value
	\$	\$	\$
Computer equipment	471,732	434,479	37,253
Leasehold improvements	25,193	18,753	6,440
Furniture and equipment	101,647	60,922	40,725
Computer software	42,183	31,088	11,095
	640,755	545,242	95,513



Sterne Stackhouse Inc.
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NOTES TO FINANCIAL STATEMENTS

October 31, 1997 and 1996

3. PROGRAM DEVELOPMENT COSTS

Additions to and amortization of program development costs during the year are as follows:

	1997	1996
	\$	\$
Balance, beginning of year	507,418	401,582
Additions		
Salaries	371,901	294,942
Depreciation on computer equipment	29,779	15,678
Other	14,176	62,997
	415,856	373,617
	923,274	775,199
Less		
Investment tax credits	—	(168,734)
	923,274	606,465
Amortization	(122,327)	(99,047)
Balance, end of year	800,947	507,418

4. BANK INDEBTEDNESS

Bank indebtedness consists of:

	1997	1996
	\$	\$
Bank overdraft	—	113,258
Demand loan	—	125,000
		238,358

The Company's demand bank loan bears interest at the bank's prime rate plus 1.5%, which rate was 6.75% at October 31, 1997 (1996 - 6.5%) and is collateralized by a general assignment of book debts, a chattel mortgage on certain computer equipment, and personal guarantees by certain shareholders.

The Company has a \$125,000 unused credit facility.



Sterne Stackhouse Inc.

Incorporated under the laws of Alberta

NOTES TO FINANCIAL STATEMENTS

October 31, 1997 and 1996

5. LONG-TERM DEBT

Long-term debt consists of:

	1997 \$	1996 \$
Small business loans	15,265	32,509
Patient capital loan	453,516	250,000
Less current portion	(138,961)	(17,244)
	329,820	265,265

The Company has two small business loans bearing interest at prime plus 1.75%, which rate was 6.75% at October 31, 1997 (1996 - 6.5%). Each loan requires monthly principal plus interest payments to maturity on June 1 and December 1, 1998 respectively. Collateral for these loans is a general assignment of book debts, a chattel mortgage on certain computer equipment and personal guarantees by certain shareholders.

The patient capital loan under the Western Economic Development Program bears interest at prime plus 4%, which rate was 9.25% at October 31, 1997 (1996 - 9%) and is repayable at \$10,308 monthly plus interest. Further, a minimum of 25% of net cash flow is to be applied as a principal reduction annually.

Principal repayments on total long-term debt is as follows:

	\$
1998	138,961
1999	125,178
2000	123,696
2001	80,946
	468,781



Sterne Stackhouse Inc.

Incorporated under the laws of Alberta

NOTES TO FINANCIAL STATEMENTS

October 31, 1997 and 1996

6. SHARE CAPITAL

Authorized

Unlimited Preferred Shares, Series A and Series B
Unlimited Common Shares

Issued	Number of Shares	\$
Common shares as at November 1, 1995	3,603,988	568,993
Issued for cash	525,000	52,500
Issued on exercise of options	3,000,000	30,000
Cancelled on consolidation (two-for-one)	(3,564,492)	-
Less: Cost of Initial Public Offering	-	(8,570)
Common shares as at October 31, 1996	3,564,496	642,923
Initial Public Offering	2,000,000	1,200,000
Less: Issue costs (net of related deferred income taxes of \$89,000)	-	(109,782)
Common shares as at October 31, 1997	5,564,496	1,733,141

As at October 31, 1997, the Company had granted the following options:

- (a) to its agent under the Public Offering, 200,000 common shares at \$0.60 per share expiring January 16, 1999;
and
- (b) to its directors, officers and employees a total of 480,000 common shares at \$0.60 per share expiring on
December 23, 2001.



Sterne Stackhouse Inc.
Incorporated under the laws of Alberta

NOTES TO FINANCIAL STATEMENTS

October 31, 1997 and 1996

7. INCOME TAXES

The provision for income taxes differs from the amount that would have been expected by applying corporate income tax rates to income before taxes. The principal reasons for this difference are as follows:

	1997	1996
	\$	\$
Income (loss) before income taxes	195,687	(182,047)
Statutory income tax rate	44.62%	
Anticipated income tax expense	87,300	—
Non-deductible items	13,400	—
Other items	(7,700)	—
Deferred income tax provision on income statement	93,000	—
Deferred income tax reduction related to share issue costs <i>[note 6]</i>	(89,000)	—
Changes in deferred tax in the year	4,000	—

The Company has investment tax credits carryforward of \$140,000 (1996 - \$15,018) which may be used to offset federal taxes payable in future years.

The potential benefit of these amounts has not been recorded in these financial statements.

8. NET INCOME PER SHARE

	1997	1996
	\$	\$
Net income per common share		
Basic	0.02	(0.07)
Fully diluted	0.02	(0.07)
Weighted average number of common shares	5,231,163	2,514,496



Sterne Stackhouse Inc.

Incorporated under the laws of Alberta

NOTES TO FINANCIAL STATEMENTS

October 31, 1997 and 1996

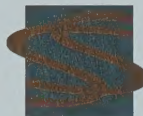
9. COMMITMENTS

The Company has leases on its premises and certain computer equipment which expire in 2002. Minimum annual rentals under the leases are approximately as follows:

Fiscal Year	\$
1998	179,500
1999	179,500
2000	168,500
2001	113,300
2002	103,900
	744,700

10. RELATED PARTY TRANSACTIONS

At October 31, 1996, accounts payable and accrued liabilities include a \$56,100, 9% advance from an officer and director of the Company. This amount was repaid during 1997.



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CORPORATE INFORMATION

Management and Officers

H. Ronald Sterne
President & C.E.O.

Darryl K. Stackhouse
Vice-President & C.F.O.

Directors

H. Ronald Sterne
Calgary, Alberta

Darryl K. Stackhouse
Calgary, Alberta

George A. Wilson, Q.C.
Toronto, Ontario

Douglas R. Martin
Calgary, Alberta

Head Office

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700 - 4th Avenue S.W.
Calgary, Alberta T2P 3J4

Stock Exchange Listing

Alberta
(Trading Symbol: SSX)

Registrar and Transfer Agent

Montreal Trust
Calgary, Alberta

Bankers

The Royal Bank of Canada
Calgary, Alberta

Auditors

J.R.S. Stankiewicz
Ernst & Young
Calgary, Alberta

Solicitors

Jay Zammit
Burstall Ward
Calgary, Alberta



Labrador®
INTELLIGENCE SYSTEMS

A Division of Sterne Stackhouse Inc.

SSX on the ASE

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